The Financial Express

In defence of growth

Mirza Azizul Islam | Published : 30 May 2017, 19:48:51

The focus on acceleration of growth, specifically growth of gross domestic product (GDP), has come under serious attack by many eminent economists as well as politicians and civil society organisations. The attack has been triggered by the rising inequality of income and wealth, particularly in developed countries. The result of referendum in favour of Britain's exit from European Union (EU) as well as the election of Donald Trump is also partly attributable to concerns about equity despite reasonable GDP growth. In the United States, the share of national income accruing to bottom 50 per cent declined from 20 per cent in 1980 to 12 per cent in 2014. Top 1.0 per cent earned 81 times more income than bottom 50 per cent in 2014 compared to 21 times in 1980. The anxiety over inequity is, therefore, understandable. However, its impact on economic and social indicators has to be evaluated in a nuanced manner, especially in developing countries like Bangladesh with low per capita income.

That GDP is an imperfect indicator of a country's welfare has been known to economists since long. The limitations arise from the facts that GDP (a) does not take into account the value of goods and services which are not traded in the market; (b) fails to take into account negative externalities, including pollution of the environment; (c) ignores other indicators of human welfare such as education and health and (d) misses the adverse impact on social stability arising from deteriorating income distribution.

Nevertheless, there are a number of convincing arguments as to why low-income developing countries cannot afford to undermine the importance of growth acceleration in their development strategy. Some of these are briefly noted below.

First, rising income in equality is almost an inevitable byproduct of growth. This is amply demonstrated by data in Table-1 which shows that 7.0 out of 10 Asian countries experienced rising income inequality measured by Ginicoeffient. Only three countries (Malaysia, Pakistan and Thailand) did not suffer any deterioration, but these were also countries which achieved relatively slow growth in recent times. I have explained elsewhere the underlying reasons for such outcome. These have to do with structural change in output (e.g., shift from agriculture to manufacturing and higher value-added service), changing skill requirements of the labour force which increase inequality within the labour force and rising disparity between regions within a country.

Second, a more important reason why growth of GDP should remain arguably as the most important development objective in low-income countries is its impact on reduction of poverty. I was involved in a study by the United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) in late 1990s to examine the relationship between growth and poverty in Asian countries. It was found that growth exerts dominant influence on poverty alleviation; income distribution plays a positive but quantitatively much smaller role. At the global level a recent IMF study shows that growth in average income explains 70 per cent of poverty reduction in the short run and 97 per cent in the long run. Data in Table-2 also confirm that despite rising income inequality there has been notable fall in the proportion of population below poverty line.

Third, data from 16 Asian countries (10 countries included in Table 1 and 2 plus Singapore, Republic of Korea, Bhutan, Laos, Cambodia and Nepal) show a high correlation between per capita income and human development index (HDI) which is a composite index including health and education dimensions reported by the United Nations Development Programme (UNDP). The correlation coefficient is 0.82 which is significant at 99 per cent level. This happens partly because growth enables governments to mobilise resources for provision of public services that contribute to various aspects of human development of the poor (health, education, social safety net programme, etc.)

The policy implication of the above analysis is that Bangladesh, at its present stage of development, cannot afford to undermine the importance of growth acceleration even if it involves some deterioration in income distribution. Downplaying the role of growth in the interest of improved income distribution would tantamount to throwing out the baby with bath water.

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Editor : A.H.M Moazzem Hossain

Published by the Editor for International Publications Limited from Tropicana Tower (4th floor), 45, Topkhana Road, GPO Box : 2526 Dhaka- 1000 and printed by him from City Publishing House Ltd., 1 RK Mission Road, Dhaka-1000.

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